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December 7, 2004

EX PARTE

Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, S.W.
Washington, DC 20554

Re: *Unbundled Access to Network Elements*, WC Docket No. 04-313;

Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, CC Docket No. 01-338;

Dear Ms. Dortch:

BellSouth Telecommunications, Inc. ("BellSouth") submits this ex parte letter to address the issue of special access conversions. In 1999 the Federal Communications Commission ("Commission") established a regulatory mandate that allowed carriers to "convert" or "re-price" certain special access circuits to unbundled network elements ("UNEs") at TELRIC prices.[1] Whatever the merits of that approach when it was adopted, it serves no public policy purpose today and should be eliminated. In today's circumstances, a continued requirement that incumbent local exchange carriers ("ILECs") re-price or convert special access circuits into lower-priced UNE facilities would be nothing more than a Commission-mandated wealth transfer among private companies. Architecture or eligibility criteria that may govern the use of certain combinations of UNEs do not address this basic policy concern.

Eliminating this opportunity for regulatory arbitrage also is consistent with, if not required by, the D.C. Circuit's *USTA II* decision because a competing local exchange carrier ("CLEC") that is using special access to serve a customer cannot be impaired without access to

[1] *See Implementation of Local Competition Provisions of the Telecommunications Act of 1996, Third Report and Order and Fourth Notice of Proposed Rulemaking,* 15 FCC Rcd 3696, 3906-3910, ¶¶ 474-482 (1999) (*"UNE Remand Order"*), *petitions for review granted, United States Telecom Ass'n v. FCC,* 290 F.3d 415 (D.C. Cir. 2002), *cert. denied,* 538 U.S. 940 (2003).

UNEs – the carrier is already serving the customer without UNEs.[2] Indeed, by eliminating the ability of CLECs to convert special access to UNEs, the Commission will have taken to heart the D.C. Circuit's admonition that the Commission "must consider the availability of tariffed ILEC special access services when determining whether would-be entrants are impaired …."[3]

Special Access and High-Capacity UNEs

Carriers have used special access circuits to connect to larger business customers for years. The Commission recognized that this market segment was subject to competition more than a decade ago and has continually recognized the growing competition to serve larger business customers with special-access facilities.[4] Indeed, as the Commission noted in 1992, basic economics favored special access competition because "[t]raffic density is greater, and costs lower, in most central city areas where large concentrations of high volume customers are located." *Special Access Order* ¶ 175.

Most connections with these larger business customers in BellSouth's region are ordered as special access today. For example, approximately 87% of all DS-1 loop and transport combinations and over 99% of all DS-3 loop and transport combinations are purchased from BellSouth as special access circuits.[5] Carriers that use special access circuits typically make use of discounted pricing plans and sometimes negotiate contract tariffs with individualized service measurements and guarantees.[6] As a result of these negotiations and competition, BellSouth's special access prices are declining more rapidly now than before BellSouth was granted pricing flexibility.[7]

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[2] *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, Report and Order and Order on Remand and Further Notice of Proposed Rulemaking,* 18 FCC Rcd 16978 (2003) ("*Triennial Review Order*"), *vacated in part and remanded, United States Telecom Ass'n v. FCC,* 359 F.3d 554 (D.C. Cir. 2004) ("*USTA II*"), *cert. denied, NARUC v. United States Telecom. Ass'n,* 04-12, 04-15 & 04-18 (U.S. Oct. 12, 2004).

[3] *USTA II*, 359 F.3d at 577.

[4] *See, e.g., In re: Expanded Interconnection with Local Telephone Company Facilities and Amendment of the Part 69 Allocation of General Support Facility Costs*, CC Docket Nos. 91-141 and 92-222, *Report and Order and Notice of Proposed Rulemaking*, 7 FCC Rcd 7369, ¶¶ 7451-52 (1992) ("*Special Access Order*") (recognizing in 1992 that "competition is already developing relatively rapidly in the urban markets and will only accelerate with the implementation of expanded interconnection"); *In the Matter of Expanded Interconnection with Local Telephone Company Facilities*, CC Docket No. 91-141, *Second Report and Order and Third Notice of Proposed Rulemaking*, 8 FCC Rcd 7374, 7423-25 (1993).

[5] Reply Affidavit of Shelley W. Padgett ¶ 87.

[6] *See, e.g.,* Reply Affidavit of Nancy Starcher ¶¶ 4-19 (outlining BellSouth's primary discount plans for special access customers and describing BellSouth's Service Assurance Warranty and Service Installation Guarantee, which require the payment of credits to special access customers when BellSouth fails to meet certain performance standards).

[7] *See* Appendix 1. For example, special access DS-1 declined at an average real rate of roughly 5 percent annually during price regulation, while the rate of decline after BellSouth obtained special access pricing flexibility relief was approximately 14 percent per year.

The use of special access varies considerably by carrier. In BellSouth's region, carriers such as Time Warner and US LEC, as well as AT&T and MCI, rely heavily on special access circuits to serve business customers.[8] Some carriers have adopted a different business strategy, principally ordering UNE loop and transport combinations to create connections equivalent to special access service. For example, carriers such as ATI and Talk America order over 90 percent of their high capacity services as UNEs, while XO and Xspedius order about 75 percent of such services as UNEs.[9] Other carriers rely on their own network facilities to serve the business market.[10]

The Conversion Requirement Serves No Public Policy Purpose

The requirement allowing carriers to "re-price" or "convert" their special access circuits to much lower-priced UNE facilities was adopted in the *UNE Remand Order*, which attempted to establish a lawful list of UNEs in response to the Supreme Court's remand in *Iowa Utilities Board.*[11] This requirement was never formalized in a rule but rather was adopted in the context of the Commission's reinstatement of 47 C.F.R. § 51.315(b), which prohibits an incumbent from separating "requested network elements that the incumbent LEC currently combines." In so doing, the Commission concluded that incumbents were required to provide requesting carriers access to combinations of loops and dedicated transport network elements that are currently combined and purchased through special access tariffs, and moreover "requesting carriers [were] entitled to obtain such existing loop-transport combinations at unbundled network element prices."[12]

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[8] *See* Appendix 2, which provides a breakdown, as of October 2004, of each carrier in BellSouth's region that purchased special access from BellSouth as well as the number of DS-1, DS-3, and total special access circuits that each carrier purchased. Appendix 2 is proprietary.

[9] ATI Wigger Declaration at ¶ 52; Talk America Brassselle Declaration at ¶ 15; XO Tirado Declaration at ¶ 44; Xspedius Falvey Declaration at ¶ 36; *see also* Ex Parte Letter from Brad E. Mutschelknaus, Counsel to the Loop and Transport CLEC Coaltion, to Marlene Dortch, Secretary, FCC (October 18, 2004).

[10] *See* Ex Parte Letter from Jonathan Banks, BellSouth, to Marlene Dortch, Secretary, FCC (November 8, 2004) (noting that Cox and Time Warner Cable acknowledge providing high-capacity service to approximately 250,000 business customers nationwide); UNE Fact Report 2004 at I-2, Table 1.

[11] *AT&T Corp. v. Iowa Utilities Board,* 525 U.S. 366 (1999).

[12] *UNE Remand Order,* 15 FCC Rcd 3696, 3909 ¶ 480. Shortly after the *UNE Remand Order* was released, the Commission supplemented that decision to respond to the serious policy concerns relating to the potential for ILECs to be required to re-price a large part of their exchange access facilities at the much lower UNE rates. To address these concerns, the Commission required that the carrier seeking to convert special access facilities be providing a "significant amount of local exchange service" and adopted three "safe harbor" scenarios to determine when this test had been met. *See Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, Supplemental Order Clarification,* 15 FCC Rcd 9587 (2000).

Whatever the merits that the Commission's conversion requirement may have had in 1999 when the *UNE Remand Order* was issued, it no longer serves any public policy purpose today. Prior to 1999, the status of high-capacity UNE loop and transport combinations that could substitute for certain special access circuits was uncertain. In addition, policies and provisioning practices regarding high-capacity UNEs and UNE combinations had not been subject to thorough regulatory review and approval. And, performance data demonstrating nondiscriminatory ordering, provisioning and maintenance of high-capacity UNEs was not generally available. Consequently, prior to the *UNE Remand Order*, carriers could argue that they were forced to some extent to order special access rather than UNEs.

Of course, that is not the case today. BellSouth implemented a simplified conversion process in October 1999 and has made available high-capacity UNE loop and transport combinations since February 2000.[13] During the Section 271 process, the Commission carefully reviewed BellSouth's high-capacity UNE provisioning policies and practices and determined that they complied with the Telecommunications Act of 1996 ("1996 Act").[14] The Commission also concluded that performance measures and performance assurance plans would ensure continued nondiscriminatory access to high-capacity UNEs.

The Commission's conversion requirement also is flawed because it gives a competitive advantage to a carrier using special access when these circuits are converted to UNEs. In the *Triennial Review Order* the Commission concluded with little analysis that normal nonrecurring charges and fees associated with ordering UNEs could interfere with "legitimate conversions."[15] Thus, the Commission directed that conversions should be treated largely as a billing change and that a CLEC may convert special access circuits to UNEs without the payment of "termination charges, re-connect and disconnect fees, or nonrecurring charges associated with establishing a service for the first time."[16]

Although the Commission concluded that such charges and fees were discriminatory in violation of Section 251(c)(3) and Section 202(a) because ILECs "are never required to perform a conversion in order to continue serving their own customers," a CLEC that is using UNEs must pay such fees when it establishes service for the first time. Thus, by exempting CLECs that convert special access to UNEs from the payment of charges and fees, the Commission's

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[13] Reply Affidavit of Shelley W. Padgett ¶ 8.

[14] *See, e.g.,* Memorandum Opinion and Order, *Joint Application by BellSouth Corp., et al., for Provision of In-Region, InterLATA Services in Georgia and Louisiana,* CC Docket No. 02-35, FCC 02-147, at ¶ 232-237 and fn.912 (2002) (Commission commitment to monitor high-capacity loop provisioning); Memorandum Opinion and Order, *Joint Application by BellSouth Corporation, BellSouth Telecommunications, Inc., and BellSouth Long Distance, Inc. for Provision of In-Region, InterLATA Services in Florida and Tennessee,* WC Docket No. 02-307, FCC 02-331 (2002), at ¶ 139-143 (also noting BellSouth policy providing for conversions of special access circuits to UNE combinations) and n.488 (reviewing BellSouth provisioning policies and noting that BellSouth builds new UNE facilities to fulfill orders).

[15] *Triennial Review Order* ¶ 587.

[16] *Id.*

conversion rule discriminates against CLECs that have elected to use UNEs instead of special access, since they must pay such charges and fees when establishing service.

The Commission's current conversion requirement simply transfers wealth between carriers while serving no pro-competitive or pro-consumer purpose. The Commission's UNE and special access policies should be aimed at setting ground rules that promote competition, not creating opportunities for regulatory arbitrage. To the extent that a carrier using special access decides to use UNEs instead, the market should determine how quickly and how far that substitution goes as customers react to competitive offers. A regulatory entitlement to "re-price" special access circuits at UNE rates creates a very different dynamic. This base of circuits would be subject to bulk conversion to UNEs by single carrier decisions, rather than by the gradual process of competing for retail customers. This would create the possibility of a massive wealth transfer between carriers through a shift to unbundled facilities without any market constraint.

Public benefits from this wealth transfer are unlikely given that it would occur where UNE facilities have proven unnecessary to compete for and win a customer. Since most large businesses that are served by special access enter into long-term contracts for their telecommunications needs,[17] the mandated price breaks enjoyed by the carrier converting from special access to UNEs would flow for the term of the contract only to the carrier and not to the customer. Furthermore, such an approach, which forces down prices for high-capacity facilities to TELRIC levels, is likely to substantially lessen incentives to invest in such facilities and greatly increase the amount of mandated unbundling and its attendant social costs.

A number of carriers contend that, at times, they were effectively forced by certain ILECs to purchase special access circuits where they would have preferred UNEs.[18] For example, some carriers allege that CLEC orders for UNEs – particularly EELs – were rejected due to "no facilities" being available, only to have such facilities become available if the CLEC ordered special access.[19]

BellSouth has never engaged in this practice.[20] Furthermore, the Commission has reviewed and approved BellSouth's policies and provisioning practices regarding UNE loop and transport combinations, and the ongoing performance data filed by BellSouth conclusively establishes that BellSouth has provided and continues to provide nondiscriminatory access to high-capacity UNEs. The fact that certain CLECs use UNE high-capacity facilities to serve over 90% of their customers, as discussed above, suggests that alleged problems with obtaining access to such UNEs are overstated.

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[17] *See*, Initial Comments of AT&T Corp. at 113 ("An important feature of the enterprise market is that large enterprise customers take service under multi-year term contracts")

[18] *See, e.g.,* CLEC Loop and Transport Coalition Reply Comments at 45-53.

[19] *Id.* at 45-48.

[20] Reply Affidavit of Shelley W. Padgett, ¶ 5.

In any event, to the extent an ILEC has engaged in anticompetitive practices in provisioning high-capacity UNEs, this matter can be handled through an enforcement proceeding or through a waiver mechanism initiated by the CLEC. However, such limited conduct does not warrant and cannot justify the continuation of a regulatory requirement applicable to the entire industry, particularly when that requirement serves no public policy purpose and is inconsistent with the concept of impairment.

The Conversion Requirement Is Inconsistent With USTA II

In addition to the Commission's conversion requirement serving no rational public policy, it violates the impairment inquiry the D.C. Circuit directed the Commission to conduct. As the D.C. Circuit explained in *USTA II,* "competitors cannot generally be said to be impaired by having to purchase special access from ILECs, rather than leasing the necessary facilities at UNE rates, where robust competition in the relevant market belies any suggestion that the lack of unbundling makes entry uneconomic."[21]

A carrier that is using special access to serve an existing customer can hardly be said to be impaired when the carrier has won the competitive battle for that customer without the need for UNEs. Thus, when a carrier has purchased and is using special access to serve a customer, the lack of unbundling does not make competitive entry "uneconomic" and, by definition, does not satisfy the impairment standard. Allowing a carrier to obtain UNEs through the special access conversion process absent impairment runs afoul of *USTA II.*[22]

When a CLEC is using special access to serve an existing customer, there also are no "administrability issues" or concerns about "ILEC abuse" that might otherwise support an impairment finding "on an appropriate record" despite the availability of special access services.[23] In the case of an existing special access circuit that is being purchased by a CLEC to serve an existing customer, the CLEC and the ILEC have agreed upon the price to be charged, often pursuant to long-term contracts. As a result, competition without UNEs for that customer

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[21] *USTA II*, 359 F.3d at 592.

[22] Although some parties have sought to distinguish *USTA II* by claiming that -- unlike in the wireless market -- "robust competition" does not exist the local market, such claims simply are not credible. BellSouth has submitted data which establish that CLECs have a significant percentage of the high-capacity services market – data confirmed by an independent study recently conducted by the North Carolina Utilities Commission of competitive entry in North Carolina. *See*, Reply Affidavit of Nancy Starcher ¶¶ 31-35; Ex Parte letter from Bennett L. Ross, Counsel to BellSouth, to Marlene H. Dortch, Secretary, FCC (Nov. 17, 2004) (noting results of North Carolina study indicating that CLECs have an approximately 60% share of both the non-switched digital private line-DS-1 or greater connections makret and the switched DS-1 market in North Carolina). Furthermore, in WC Docket 02-112, *Susnet fo the BOC Separate Affiliate and Related Requirements*, BellSouth filed data documenting the CLEC share of the business market in each of its nine states, a copy of which is enclosed as Appendix 3. *See* Letter from Mary L. Henze, BellSouth, to Marlene H. Dorth, Secretary, FCC (July 28, 2004). It is beyond the pale for any party to claim that a market in which the CLECs have an approximately 30 to 40 percent share is not "robustly competitive."

[23] *USTA II*, 359 F.3d at 577.

already exists, and the ILEC cannot increase the price for the special access circuit during the term of the contract. As the D.C. Circuit noted, when market evidence demonstrates that existing rates outside of UNEs "don't impede competition," and when the ILEC would not "be able to drastically hike those rates," possible concerns about "administrability issues" and the "risk of ILEC abuse" "recede even farther in the background."[24]

To be sure, the Commission adopted eligibility criteria that govern the access to UNE high-capacity loop and transport combinations – criteria that the D.C. Circuit found were "reasonable" albeit "imperfect."[25] By establishing a prerequisite that a carrier be capable of providing some local service over circuits before TELRIC re-pricing is required, these criteria may reduce the amount of conversions. However, the criteria currently apply only to conversions to combinations of UNEs and may not apply to conversions to standalone UNEs. Even should the criteria apply in both cases, they do not address the basic issue that conversions do not make policy sense or pass legal muster.

The Court of Appeals addressed these criteria as they relate to a CLEC seeking to obtain EELs to provide a particular service such as long distance for which the CLEC is not impaired. The D.C. Circuit did not address whether a CLEC can lawfully convert special access to UNEs when, for example, the CLEC was using special access to provide local service, noting that this was an "independent" issue:

> As we discussed in the section on wireless carriers, the presence of robust competition in a market where CLECs use critical ILEC facilities by purchasing special access at wholesale rates, i.e., under § 251(c)(4), precludes a finding that the CLECs are 'impaired' by lack of access to that element under § 251(c)(3). We realize that this might create anomalies, as CLECs hitherto relying on special access might be barred from access to EELs as unbundled elements, while a similarly situated CLEC that had just entered the market would not be barred. On the other hand, if history showed that lack of access to EELs had not impaired CLECs in the past, that would be evidence that similarly situated firms would be equally unimpaired going forward.[26]

The D.C. Circuit directed the Commission to "consider and resolve any potential anomaly on remand." The Commission should do so by eliminating its requirement allowing the conversion of special access to UNEs.

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[24] *Id* at 592.

[25] *USTA II*, 359 F.3d at 592.

[26] *USTA II*, 359 F.3d at 593.

The Commission Should Eliminate Its Conversion Requirement

There is no legitimate legal or policy basis to continue the Commission's current conversion policy, and it should be eliminated. Under BellSouth's proposal, eliminating the current conversion rule would not affect the availability of UNEs. Where UNEs are available based on the Commission's impairment test, carriers could choose to order UNEs to compete for customers currently served over special access arrangements. Where this competition occurs, it is very likely that the ILECs will continue offering advantageous pricing arrangements in order to avoid handicapping their special access customers relative to UNE providers. Where a discounted special access arrangement is not perceived as adequate, that carrier could order UNEs, but would have to pay the same charges and fees paid by other carriers seeking to install UNE circuits to serve that customer.

Eliminating the conversion or re-pricing requirement would simply force carriers to abide by their business decisions, which hardly seems too much to ask. Many CLECs have elected to purchase special access on a month-to-month basis, even though it means forgoing the discounts associated with long-term contracts. For example, some facilities-based CLECs purchase approximately 70 to 80 percent of their special access circuits on a month-to-month basis, apparently mindful of the Commission's admonition that carriers "take into account the possibility of future conversions to UNE combinations" before entering into long-term contracts.[27]

By contrast, some CLECs purchase approximately 90% of their special access pursuant to long-term contracts.[28] These CLECs have elected to enter into such contracts to avail themselves of deep discounts that are available with long-term agreements while forgoing the flexibility associated with month-to-month arrangements. Regardless of whether these CLECs could meet the Commission's current architecture test, requiring re-pricing at TELRIC of special access circuits is unjustified as a matter of law and policy, as explained above.

For the foregoing reasons, BellSouth urges the Commission to: (i) eliminate its re-pricing or conversion requirement; (2) direct that any CLEC that purchases special access must abide by the terms of its contract; and (3) make clear that if a CLEC decides to terminate its contract and buy UNEs instead of special access, it must pay all applicable charges under that contract as well as all applicable fees that would be paid by a CLEC when first establishing service via UNEs.

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[27] *See* Appendix 4, which is a list of those carriers that purchased on an annual basis $3 million or more of special access services from BellSouth and which provides a breakdown of the monthly special access charges paid by each carrier and the amount and percentage of such charges that were month-to-month. Appendix 4 is proprietary.

[28] *See* Appendix 4 (proprietary)

Please include this letter and the enclosed Appendices in the record in the referenced proceedings.

Sincerely,

Bennett L. Ross

BLR:kjw

Enclosures

cc: Christopher Libertelli
Matthew Brill
Jessica Rosenworcel
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